Economic Commentary

TrustINdiana

Market Commentary for **September 2008**

A Tumultuous Time

The credit crunch during September intensified to the point where Lehman Brothers and Washington Mutual filed for bankruptcy protection, AIG needed an $85 billion dollar line of credit from the Federal Reserve, and the government fast-tracked a comprehensive bailout plan that provides support to the overall market. To make matters worse, the outlook for the U.S. economy is beginning to deteriorate at an increasing rate. Second quarter Gross Domestic Product (GDP) growth has been revised downward from 3.3 percent to 2.8 percent. More alarming is that GDP growth is projected to be 1.0 percent in the third quarter and 0.2 percent in the fourth. While the U.S. economy is not yet technically in a recession, which is defined as two consecutive quarters of negative growth, there is a 43 percent chance it will be in the next six months, according to Moody's.

September payrolls also plunged to a five year low, which marked the ninth consecutive month of payroll declines. It also appeared to have affected nearly every corner of the labor market as the average workweek decreased to 33.6 hours, the second lowest level since the survey began in 1964. The actual unemployment rate held at steady 6.1 percent. The Institute for Supply Management (ISM) manufacturing index tumbled 6.4 points to 43.5, its lowest level since 2001, largely because of a steep decline in exports. ISM manufacturing index readings below 50 indicate contracting activity in the manufacturing sector and readings below 43 indicate that the economy is in a recession.

Furthermore, home prices continued to plummet. Existing home sales managed only 5 million annualized units during September, an 11 percent drop from a year ago, and new home sales declined 34.5 percent year-over-year. The Case-Schiller survey of prices in 20 major cities showed drops across the board, even in real estate market stalwarts like New York City and San Francisco. Hardest hit was Las Vegas, where the value of the average home fell 29.9 percent between July 2007 and July 2008. The national average home value dropped 12 percent.

The Federal Open Market Committee met on September 16 and kept the fed funds target rate at 2 percent for the third consecutive meeting. According to the meeting statement, the Fed is not optimistic about economic conditions, "Strains in financial markets have increased significantly and labor markets have weakened further. Economic growth appears to have slowed recently, partly reflecting a softening of household spending. Tight credit conditions, the ongoing housing contraction, and some slowing in export growth are likely to weigh on economic growth over the next few quarters." The statement went on to say that the outlook for inflation remains highly uncertain.

Sector Review

U.S. Treasuries: The Treasury market was well-bid all month as the credit crunch further paralyzed banks and brokerages. In a stunning series of events, companies that had been part of the financial industry landscape became casualties of the crisis. Lehman Brothers filed for the largest bankruptcy in United States history and other firms such as Merrill Lynch raced to find suitors. The 10-year note yield inched upwards to a 3.82 percent yield from a 3.81 percent yield the prior month. The two-year note yield decreased to a 1.96 percent yield from a 2.38 percent yield while the three-month bill saw yields plunge to 0.90 percent from 1.71 percent as investors raced to the most risk-averse product available. (Rates and prices maintain an inverse relationship. Prices decrease as yields increase).

Commercial Paper: The unexpected bankruptcy of Lehman Brothers resulted in increased pressure in the commercial paper markets as investors began to steer their money towards government guaranteed paper. Rates experienced a steep rise as this cycling of money into government guaranteed securities left fewer buyers of commercial paper. One-month, top-tier, higher quality asset-backed commercial paper (ABCP) names traded between 3.50 percent and 4.50 percent and three-month paper traded between 4.00 percent and 4.50 percent.

U.S. Government Agencies: It is official. Fannie Mae and Freddie Mac became entities of the U.S. Government and its Board of Directors was shown the door while holders of equity were further displaced in the capital structure. Both entities' paper was in high demand and yields reflected this change of investor appetite. Agency yields at month-end on three-month paper yielded near 2.00 percent, six-month paper yielded 2.85 percent, and 12-month paper yielded 3.00 percent.

Strategy: The Federal Reserve continued to keep its target rate at 2.00 percent after its September meeting. Most of their efforts have been focused on the creation of numerous vehicles to help the banking system remain as orderly as possible, which also included helping distressed entities find a willing buyer. During this highly difficult period in the financial markets, our portfolio focus for short-term accounts has become more defensive with an emphasis on maintaining short maturities and cycling more cash towards government guaranteed entity bonds.

DJIA		NASDAQ		S&P 500	
-6.00%	-18.20%	-11.64%	-21.12%	-9.07%	-20.56%
Month	Year-to-Date	Month	Year-to-Date	Month	Year-to-Date

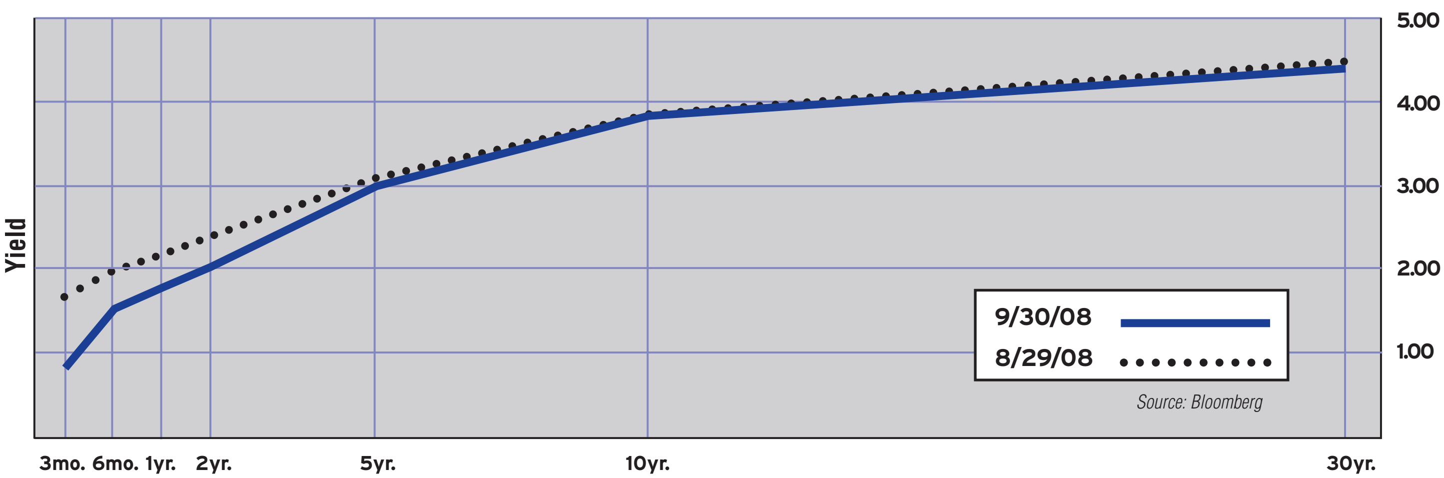
The opinions expressed above are those of Texas CLASS and are subject to change without notice. All statistics represent month-end figures unless otherwise noted.

Market Summary for **September 2008**

Monthly Market Summary - Week-ending Rates and Yields

	09/05	09/12	09/19	09/26	3rd QTR AVG	2nd QTR AVG	1st QTR AVG
Overnight Rates							
Effective Fed Funds	1.97	2.10	1.48	1.08	1.90	2.07	3.19
Repurchase Agreements	1.95	2.15	1.75	1.00	1.89	2.02	2.67
Discount Rates							
1 Month Treasury Bill	1.58	1.30	0.05	0.27	1.33	1.42	2.00
1 Month Agency Disc.	2.25	2.10	2.20	2.25	2.21	2.06	2.80
1 Month Com'l Paper	2.35	2.37	3.13	3.29	2.49	2.45	3.18
3 Month Treasury Bill	1.66	1.46	0.41	0.87	1.49	1.61	2.00
3 Month Agency Disc.	2.55	2.25	2.11	2.67	2.42	2.16	2.77
3 Month Com'l Paper	2.74	2.76	2.88	3.69	2.81	2.67	3.11
6 Month Treasury Bill	1.86	1.75	0.86	1.43	1.78	1.82	2.07
6 Month Agency Disc.	2.84	2.45	2.53	2.94	2.69	2.25	2.64
6 Month Com'l Paper	3.05	3.03	3.16	3.90	3.08	2.78	3.01
Yields							
1 Year Treasury	2.07	2.02	2.05	1.81	2.16	2.07	2.07
1 Year Agency	2.89	2.62	3.11	3.05	2.91	2.68	2.58
2 Year Treasury	2.24	2.22	2.13	2.06	2.40	2.40	1.97
2 Year Agency	3.24	2.83	3.05	3.10	3.22	3.03	2.60
5 Year Treasury	2.92	2.95	3.00	3.01	3.13	3.15	2.70
5 Year Agency	3.99	3.66	3.98	4.13	4.09	3.88	3.45

Historical Yield Curve



Key Economic Indicators

	For the Period	Date of Release	Expected	Actual	Prior
Unemployment Rate	September	10/03	6.1%	6.1%	6.1%
Consumer Price Index	August	09/16	5.5%	5.4%	5.6%
- Less Food and Energy	August	09/16	2.6%	2.5%	2.5%
Consumer Conf. (CB)	September	09/30	55.0	56.7	57.9
FOMC Rate Decision		09/16	2.00%	2.00%	2.00%
Gross Domestic Product	2QF	09/26	3.3%	2.8%	3.3%

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Office of the Treasurer of Indiana

242 State House, 200 W Washington St.

Indianapolis, IN 46204

www.trustindiana.in.gov